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SUBJECT: IRAQI BANKS MOVE ELECTRONS INSTEAD OF PAPER

¶1. Summary: While Iraq's economy remains predominately cash-based, the banking system has begun a shift toward electronic payments. From December through April, Iraqi-owned banks more than quadrupled the monthly value of transactions they direct through electronic funds transfers (EFT). Private banks lead the way, with 60 percent of their branches EFT-capable, while no state-owned banks offer domestic EFT services to the public. The USG sparked this modernization, first through assistance to the Central Bank of Iraq (CBI) and then through an emphasis on electronic payments by the Joint Contracting Command - Iraq (JCCI). As banks and businesses gain experience with the speed, safety, and low cost of EFT, we expect it to slowly displace the use of cash in wholesale transactions. An important side benefit of progress in this area is that use of EFT may accelerate GOI budget execution. End summary.

¶2. In 2004 the U.S. Treasury Department contracted with New York-based Montran Corp. to build a modern payments system in Iraq through an \$18-million program to deliver equipment, technical assistance, and training to the CBI. By 2006 the new system offered both real-time gross settlement (RTGS) and automated clearinghouse (ACH) services. The ACH service, which is designed to process low-value, high-volume retail and payroll transactions, remains unused for now. But for RTGS, which is designed to process large inter-bank transfers, monthly transaction value has more than doubled since December 2007.

¶3. The expansion of EFT in Iraq is a reflection of the increasing importance of privately owned banks. While the seven state-owned banks hold 80 percent of non-GOI deposits in the system, the 32 private banks operate more than a third of the 726 bank branches in the country. About 60 percent of the branches of private banks offer EFT services, while no branches of state-owned banks are EFT capable. The private banks' modern capabilities are helping them expand their business.

¶4. The USG played a role not only in building Iraq's EFT infrastructure but also in promoting its use. In particular, the Department of Defense Task Force for Business Stability Operations (TFBSO) sought to direct more USG payments through Iraq's EFT system. In October 2007, with help from TFBSO, JCCI established a new policy to use EFT for all contract awards of \$50,000 or more. This created a snowball effect in subsequent months. By May the volume of RTGS transactions was more than triple the volume in October. The aggregate monthly value of RTGS transactions is now more than twice as high as in the first six months of 2007. Now TFBSO is working with Iraq's private banks to promote the use of ACH for retail payments.

¶5. Comment: Iraq's economy still runs mainly on cash, but with "plumbing" installed by Treasury and "pump priming" engineered by TFBSO and JCCI, Iraq's banking system has taken a big step forward. There will be greater gains when EFT moves into the retail sector with ACH services. Among other effects, EFT can begin to replace the state-owned banks' creaky, corruption-prone, cash-based system for distributing wages, pensions, and other benefits for the GOI and

state-owned enterprises -- once the GOI develops the political will to implement EFT for its own transactions. More immediately, EFT may also prove to be another way of easing bottlenecks that hamper GOI budget execution. Iraqi banks without EFT can take up to three weeks to process a payment. With EFT, the same transaction can be completed in less than a day.

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